

FINANCIAL AUDIT ADVISORY COMMITTEE

REPORT

Monday, December 14, 2015

Present: Ald. Fuller (Chair), Danberg, Howard Merkowitz, and Tony Logalbo

Also present: David Wilkinson (Comptroller), Sue Dzikowski (Director of Finance; School Department), and Matt Hunt, CPA (Clifton, Larson, Allen, LLP), Mary Walsh (Planning Department Accounts Specialist), and Danielle Bailey (Planning Department Grants Manager)

06/30/2015 Audit

The Committee met with Matt Hunt of Clifton, Larson, Allen, LLP (CLA), the City's external auditing firm, to discuss CLA's review of the City's Comprehensive Annual Financial Report (CAFR) and to review the auditor's drafts of the Reports on Internal Control and Federal Awards and the Management Letter related to the Fiscal Year 2015 Audit. The Committee members received copies of all documents related to the audit. The CAFR can be found on the City website under the following link:

<http://www.newtonma.gov/civicax/filebank/documents/70590>.

Mr. Hunt began the discussion by reviewing the Auditor's Management Letter. Mr. Hunt made it clear that the management letter does not identify the strengths of the city's financial systems. The Management Letter comments and recommendations have been shared with City personnel and the auditors are willing to discuss them further with City representatives.

Management Letter

Mr. Hunt began by stating that the auditors did not identify any deficiencies in internal control that they consider to be material weaknesses.

Mr. Hunt stated that three of the seven comments from the previous year's management letter were resolved. The resolved comments relate to the creation of policies and procedures for accounts receivables in the Inspectional Services Department, implementation of documentation and procedures for the student activity funds at the Bigelow Middle School, and utilization of an independent third party to conduct tests of the information technology environment that includes an internal vulnerability assessment and a general controls review. A summary of the resolved comments are included in this year's management letter.

In addition, this year's management letter contains two prior year comments that have been partially resolved. The first partially resolved issue relates to risk assessment and monitoring. The City has established a Risk Assessment Sub-committee of the Financial Audit Advisory Committee but the auditors would like the City to (1) develop a risk assessment program to periodically anticipate, identify, analyze, and manage the risk of asset

misappropriation and (2) to develop a monitoring program that evaluates the operational effectiveness of internal controls and formally document that process. The second partially resolved issue is related to development of financial policies and procedures that clearly define the objectives, responsibilities and authorizations for all positions within the City. Formal policies and procedures related to general administration of state and federal grants were developed and posted to the web site; however, formal policies and procedures related to (1) personnel, (2) state and federal grant compliance in the Department of Planning and Development, and (3) fraud protection over bank transactions and accounts formal documentation should be developed. The Auditor maintains that the City should continue to develop and implement formal financial policies and procedures as detailed in the Management Letter

There are two prior year comments that are unresolved. First, the Police detail accounts receivables still remain an issue in this audit. The City developed and implemented a policy regarding the uncollectible police detail funds and the write-off of those funds in fiscal year 2014 but the City still has not provided a new software program designed for police detail billing and collection that is integrated with the general ledger software. The auditor recommends that the City integrate the software with the general ledger software. Second, last year the auditor also recommended that the City develop and adopt written investment policies for trust funds that are not governed by existing policies or laws. Such policies should include such areas as investment objectives, types of authorized investments, and goals for the amount of return expected. The City did not make progress on developing these policies; therefore, the issue remains unresolved in this year's Management letter.

There is one new comment this year, which is related to the Utilities Division of the Public Works Department's payroll. The auditors evaluated the internal controls surrounding payroll for employees that provided a combination of services related to water, sewer, and/or storm water activities. The auditors found that though the department uses formal policies and procedures for general payroll processes, there are no formal specific policies and procedures for the unique aspects of the Utilities Division's payroll. The auditors recommend developing and implementing written financial policies and procedures related to specific aspects of the Utilities Division payroll, as well as strengthening procedures related to the preparation and review of reports used as the basis for the Utilities Division payroll.

The Accounting and Audit Sub-committee will meet with each of the departments regarding their individual management letter comments early in 2016. The City's management team has not had an opportunity to respond to the Management Letter comments but will be responding in the near future. Once the City's management has responded to the auditors' comments and recommendations, the Management Letter with the responses from the City will be available on the City website.

Government Accountability Office (GAO) and Office of Management and Budget (OMB) A-133 Reports

The independent auditor provides reports on the internal control over financial reporting and on compliance. The report includes a statement that the prior year federal grant finding was resolved over the course of Fiscal Year 2015. The reports include any significant deficiencies and/or material weaknesses in internal controls.

There was one material noncompliance and material weakness identified in the Emergency Solutions Grant internal control over compliance administered by the City's Planning Department. Federal guidelines require that the City monitor the sub-recipients and ensure that those that expend more than \$500,000 of award funds in the fiscal year have met the OMB A-133 audit requirements; the City failed to do this monitoring. The auditors recommend procedures be implemented to monitor the sub-recipients to ensure that they are complying with the requirements. In addition the City should maintain documentation supporting the results of the monitoring procedures. The auditor noted that policies and procedures were not in place to conduct sufficient sub-recipient monitoring and that this was partially caused by a high degree of turnover in the City's Planning Department.

Planning Department representatives, Mary Walsh and Danielle Bailey, explained that the Planning Department has seen a large turnover in positions within the Community Development Block Grant Division of their department and with that turnover expertise on grant management was lost. To correct the situation, in April 2015, the Planning Department requested technical assistance from the Department of Housing and Urban Development (HUD) regarding the Emergency Solutions Grant as well as the Continuum of Care Grant. HUD provided 16 hours of remote technical assistance for the City with The Cloudburst Group, which has resulted in a new level of expertise in the Planning Department. The Planning Department began working with Cloudburst in October to begin to develop a work plan. The staff is now aware that the performance and compliance monitoring requires a formalized process and realizes it needs to perform a program-wide assessment to be done before monitoring begins. The Planning Department is currently working with Cloudburst to develop a monitoring plan that includes guidelines and schedules by the end of the year. The Planning Department anticipates that monitoring will begin in January 2016.

The auditors also found six significant deficiencies (a type of deficiency less severe than the material weakness) in the internal control over federal awards related to the Community Development Block Grant, Emergency Solutions Grant, Home Investment Partnerships Program, Home Investment Partnerships Program, Special Education Cluster and the Public Assistance Grants provided by the Department of Homeland Security. Mr. Hunt briefly reviewed each of the six deficiencies and management's planned corrective actions with the Committee. Greater detail on the deficiencies and corrective actions are included in the report available at the following link: <http://www.newtonma.gov/civicax/filebank/documents/70840>.

Comprehensive Annual Financial Report

Mr. Hunt moved onto the City's Comprehensive Annual Financial Report (CAFR), including the Management's Discussion and Analysis (MD & A) and the Budget to Actual Statement portions of the CAFR. Comptroller David Wilkinson prepares the MD & A. Mr. Hunt noted that he does a great job summarizing the data and information contained in the CAFR. The budget to actual statements provides a good window into how the City's general fund performed. The CAFR also includes the Pension Trust Fund and the Other Post-Employment Trust Fund Statements, which were reviewed by the Committee at its October 2015 meeting.

The primary fieldwork began in September 2015 and all information that was needed was provided by the City in a timely, well-organized manner. The City management and staff involved in the audit were responsive to all inquiries. There were no disagreements with management during the audit process and everything went smoothly. Clifton, Larson, Allen also included a quality control review by an independent partner outside of the auditor's Massachusetts office.

The CAFR has an introductory section that includes a letter of transmittal, a financial section that includes the auditors' opinion and the management's discussion and analysis, and a statistical section. The only GASB Statement of any impact this year is GASB 68 that requires full reporting of the net pension liability on the full accrual financial statement, expanded note disclosures and required supplementary information.

There are no new auditing standards for the Fiscal Year 2015 audit. The auditor's opinion on Fiscal Year 2015 Comprehensive Annual Financial Report is unmodified (i.e., the financial statements present fairly, in all material respects, the City's financial situation), which is in keeping with prior years. It was pointed out that part of the opinion includes reliance on the auditors that provide the audit of the City's component unit, the Newton Commonwealth Foundation.

The Statement of Net Position reported on Pages 18 and 19 of the CAFR provides the City's assets, liabilities, and net position. Currently, there is an unrestricted *deficit* of \$436.9 million in governmental activities, which is attributable to the recognition of the pension and Other Post-Employment Benefit obligations. This is the first time the City of Newton has a deficit in its net position.

Mr. Hunt reviewed the financial highlights for Fiscal Year 2015. The key information is the fund balance information, particularly for the General Fund. The City had approximately \$38.5 million in total fund balance in the General Fund that is comprised of a restricted fund balance of \$3.0 million, a committed fund balance of \$5.3 million, an assigned fund balance of \$2.5 million, and an unassigned fund balance of \$27.8 million that includes \$17.3 million in the Rainy Day Stabilization Fund. At the end of fiscal year 2015, the ratio of how much the unassigned fund balance is compared to total revenues and other financing sources was 7.9%, an increase of 0.8% from the ratio of the previous year of 7.1%. The City continues to do good

job of increasing its reserves over the past few years. The General Fund debt service as a percentage of total expenditures and transfers out is 5% (compared to 4.6% in the prior year). The Committee expects to have a future discussion on whether that is the appropriate percentage of debt service.

Mr. Hunt reviewed the financial highlights related to the enterprise funds and internal service funds. The sewer enterprise fund ended the fiscal year with assets totaling \$76 million and liabilities of \$22 million that includes both pension and OPEB liabilities. The water enterprise fund ended the fiscal year with assets of \$65 million and liabilities of \$25 million. There was an increase of \$3.3 million in net position over the past year. The Storm Water Fund will become an enterprise fund next year. The internal service funds total assets is approximately \$31 million at the end of fiscal year 2015 and liabilities totaled \$14 million, consisting mainly of incurred but not reported health claims liabilities of \$3.5 million and workers compensation liabilities of \$8.5 million. The net position of the internal service funds was \$17 million. Overall, the internal service funds decreased by about \$181,000. In addition, Mr. Hunt provided a quick review of the footnotes included in the CAFR, which can be found on the City's website at <http://www.newtonma.gov/civicax/filebank/documents/70590>.

Mr. Hunt's handout includes information on City liabilities and assets. Total outstanding long-term debt is \$244.5 million (Note 10). The OPEB unfunded actuarial accrued liability is \$701.5 million, an increase from \$554 million the prior year (Note 12). The OPEB liability is 0.3% funded with assets of \$2.1 million. The Rainy-Day stabilization fund totals \$17.3 million (Note 15). The net Pension liability is \$301.7 million and the plan is 49.35% funded.

The Committee briefly discussed how to promote a better understanding of the pension and OPEB liabilities and the city's funding plans for these liabilities to the general public. It was suggested that the Committee delve into the issue at a future meeting. Mr. Hunt added that he is happy to work with the Committee on any types of analysis they may need.

Discussion with Inspectional Services on Accounts Receivable Operations, Online Permitting, and Credit Card Payments

Commissioner of Inspectional Services John Lojek was not present; therefore, the Committee delayed the discussion until Mr. Lojek could be present.

The Committee adjourned at 9:47 a.m.

Respectfully submitted,

Ruthanne Fuller, Chair